No. 602

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

GALEN H. WELCH, Former Collector of Internal Revenue For the Sixth Collection District of California, *Petitioner*,

v.

OBISPO OIL COMPANY, a Corporation.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

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OPINIONS BELOW.

The opinion of the District Court of the United States for the Southern District of California (R. 25-43) is not reported. The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 85 F. (2d) 860.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered September 28, 1936. Petition for certiorari was filed December 28, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Did the Circuit Court of Appeals err in affirming a judgment of the District Court to a taxpayer for a refund of income taxes overpaid for the taxable year 1920, where its profits taxes for that year were determined under the provisions of Sections 327 and 328, Revenue Act of 1918?

STATUTE INVOLVED.

The statute involved will be found in the Appendix, *infra*, pp. 11-14.

STATEMENT.

The evidence introduced in the District Court is not included or summarized in the Record before this Court, but it consisted principally of Stipulations and documentary evidence (R. 44). The Record contains the trial court's Findings of Facts (R. 26-41) against which no assignment of error has been made by either party. (R. 50-51; Supp. R. 5-6.) The only findings made by the trial court which bear on the particular question here involved were as follows:

> "The Commissioner of Internal Revenue determined the profits taxes of Plaintiff for the calendar year 1920 under the provisions of Sections 327 and 328, Revenue Act of 1918, in the total amount of $142,765.73, or at the rate of 9.67 per cent of Plaintiff's income, subject to profits tax, of $1,476,330.52 for that year. The Commissioner determined the income tax of Plaintiff for 1920 as follows:

Net Income—		$1,476,330.52
Less:		
Profits tax, Section 328—	$142,765.73	
Interest on U. S. obligations not exempt—	86,134.16	
Exemption—	2,000.00	230,899.89
Balance subject to 10% tax—		$1,245,430.63
Amount of tax at 10%— (R. 40).		124,543.06''

The District Court found that the Commissioner had overstated the net income subject to income tax by $40,102.44, and rendered a judgment for the refund of income taxes overpaid in the amount of $4,010.24 (R. 42). No adjustment was made in the profits tax computation of the Commissioner. The Circuit Court of Appeals sustained the District Court (Supp. R. 18).

ARGUMENT.

Petitioner's argument is grounded upon some theory of estoppel to prevent respondent from recovering income taxes which both the lower courts have determined to have been overpaid and refundable. Respondent submits that since petitioner did not raise this point below, it is not properly before the court as a question in this case.

1. *Question Not Raised Below.* In the first place, this contention was not raised in either of the courts below. Neither in the Answer to Amended Complaint (R. 14-21) nor in the Motion for Judgment (R. 23) did defendant in the District Court plead estoppel or allege any facts to support such a claim. Likewise the Findings of Fact and Conclusions of Law made by the District Court fail to disclose that any such issue was raised (R. 25-43). Furthermore, petitioner's assignments of error upon appeal to the Circuit Court of Appeals are absolutely silent on any issue of estoppel (Supp. R. 5-6).

In the absence of such a contention before the courts below, petitioner's plea of estoppel should not be considered by this Court. *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206; *Helvering* v. *Salvage*, 297 U. S. 106, 109. In the latter case, the Supreme Court stated (p. 109):

> "The defense of estoppel was not before the Board. Under what we regard as the correct practice, General Utilities & Operating Co. v. Helvering, * * * the court should have passed the point. Furthermore, the facts disclosed give it no support."

In *General Utilities & Operating Co.* v. *Helvering, supra*, the Supreme Court stated (p. 206):

> "The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circumstances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

2. *No Basis For Estoppel.* Furthermore, there is absolutely no basis in the Record before this court for the statements made in petitioner's brief purporting to set forth facts supporting the claim of estoppel.* In substance, petitioner states (a) that special assessment of profits taxes was granted the taxpayer as a *privilege* by the Commissioner, and (b) that the privilege was granted only after

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* On pages 4 and 5, under "Reasons for Granting the Writ," counsel for petitioner make the following statements:

> "Taxpayer here has invoked the discretionary jurisdiction of the Commissioner pursuant to Sections 327 and 328 of the Revenue Act of 1918, alleging an abnormal condition affecting income for the year 1920. Pursuant to those sections the privilege of a special assessment was granted to taxpayer after the amount of net income had been agreed upon. By that agreement, the taxpayer abandoned the position that there had been any error of law or of fact in the determination of net income, and is now estopped from retracting its assent and resuming the abandoned ground."

the taxpayer had *agreed upon* the net income. Counsel fail to cite any evidence or findings in the Record to support these alleged statements of facts—none could be found.

Reference to the provisions of Section 327, Revenue Act of 1918, set forth in the Appendix hereto, will disclose that special assessment of the profits tax under Section 328 is appropriate under four situations, of which the first three, subsections (a), (b) and (c), are mandatory and only one, subsection (d), lies within the discretionary power of the Commissioner. See *Bemis Bros. Bag Co.* v. *United States*, 289 U. S. 28. Obviously, petitioner's statement that "taxpayer here has invoked the discretionary jurisdiction of the Commissioner" would be true if, and only if, the determination was made under subsection (d) of Section 327.

However, the Record is absolutely silent on this point. The District Court found merely that the profits taxes were determined "under the provisions of Sections 327 and 328, Revenue Act of 1918." (R. 40). Even petitioner's assignment of errors in the court below merely contended that the tax was determined and assessed "under the special assessment provisions of Sections 327 and 328." (Supp. R. 5). Nowhere in the Record will be found any evidence that the "privilege of a special assessment was granted" under the "discretionary jurisdiction" set forth in subsection (d), or that taxpayer alleged "an abnormal condition affecting income for the year 1920."

Likewise, there is not a shred of evidence anywhere in the Record to support petitioner's statement that the taxpayer agreed upon the amount of net income and thereby "abandoned the position that there had been any error of law or of fact in the determination of net income."

3. *No Conflict with Other Appellate Decisions.* Petitioner also contends that the decision of the court below is in conflict with decisions of various other courts. Among the cases so cited are two decisions of this Court, *United States* v. *Henry Prentiss & Co.*, 288 U. S. 73, and *Heiner* v.

Diamond Alkali Co., 288 U. S. 502, neither of which is decisive of the question here presented.

The exact holding in the *Prentiss* case is clearly stated by Mr. Justice Cardozo in *Bemis Bros. Bag Co.* v. *United States*, 289 U. S. 28, at 32, as follows:

> "We held in United States v. Prentiss & Co. supra, that after the period of limitation a claim for a special assessment under § 327 (d) may not be turned by amendment into one for the reaudit of invested capital and for the reassessment of the tax accordingly."

No such question is presented in the present case. The original claim for refund raised the issues regarding the computation of net income, and no amendment is relied upon. Likewise no question of limitations is here involved.

In *Heiner* v. *Diamond Alkali Co., supra*, the lower court held that the Commissioner's determination of net income was erroneous, applied the special assessment profits tax rate to the revised net income, and determined *refunds of both profits tax and income tax* for the year in question. The Government did not claim any error with respect to the *income tax refund*, but obtained a review by the Supreme Court of the judgment with respect to the *profits tax* determination.* The Supreme Court there held that the *profits tax* determination by the Commissioner under special assessment was conclusive upon the court and that the amount of the profits tax could not be changed even though the court determined that the net income was overstated, but did not change or question the lower court's allowance of a refund based solely upon the *income tax* computation.

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* On page 12 of the Solicitor General's brief before the Supreme Court in that case the following statement appears:

> "Petitioners do not question here the action of the courts below in reducing the *normal income tax* by increasing the deductions from gross income and applying to the reduced net income the normal tax rate prescribed by the statute. The questions presented to this Court in the instant case relate only to *profits taxes*. Attention, however, is called to the fact that there is a necessary correlation between the profits tax and the income tax since, under Sec. 236(b) of the statute, the amount of the former is allowed as a credit against net income in computing the latter."

In the present case, respondent claims and the courts below have allowed *only* the reduction in *normal income tax* to which it is justly entitled on the basis of the correct net income; the Commissioner's computation of the *profits tax* is not changed or affected to any extent whatever. This is exactly the effect of the final decision in the *Diamond Alkali Co.* case, and the effect of the only other decision of an appellate court cited in petitioner's brief, *Cleveland Automobile Co.* v. *United States,* 70 F. (2d) 365 (CCA-6th). An examination of that Court's opinion indicates that the issue considered was the power of the courts to revise the *profits tax* determined under Sections 327(d) and 328. The Court did not consider at all the *income tax* question here presented, probably because the Court *held that the Commissioner had properly determined the taxable net income.* Clearly that decision is entirely consistent with the decision of the courts below in the instant case.

The Court of Claims, in *Supplee-Biddle Hardware Co.* v. *United States,* 58 Ct. Clms. 343, assumed jurisdiction of a case in which the profits tax had been determined under special assessment and rendered a judgment for refunds of both profits tax and income tax. Yet in that case, the refund was based upon an error in the Commissioner's determination of net income.

Upon appeal, the judgment of the Court of Claims was affirmed by the Supreme Court, its opinion being reported in *United States* v. *Supplee-Biddle Hardware Co.,* 265 U. S. 189. The Supreme Court expressly noted in its opinion that:

> "The Commissioner of Internal Revenue reduced this amount by $29,584.06, in accordance with the powers conferred upon him by §§ 327 and 328 of the Revenue Act of 1918, to reduce the rate of taxation in cases of unusual hardship."

Notwithstanding this fact, the Supreme Court held the Commissioner had made an erroneous determination of net

income and that the taxpayer could recover both profits taxes and income taxes overpaid. See also *McKeever* v. *Eaton*, 6 F. Supp. 697 (D. C., D. Conn.).

These decisions demonstrate that the courts have *jurisdiction* to review the Commissioner's determination of income and profits taxes, even where the latter have been determined under special assessment; the limitation is merely upon the power of the courts to revise certain determinations made by the Commissioner under discretionary powers granted by Congress, in connection solely with the *profits tax*.

The only pertinent issue raised in the Assignment of Errors below (Supp. R. 5) was based upon the contention "that the Court has no jurisdiction over the subject matter of this action."

The decision of the court below is supported by the prior decision of the same court in *Welch* v. *St. Helens Petroleum Co.*, 78 F. (2d) 631, from which no appeal was taken by the Government.

4. *Question Not of General Importance.* The Revenue Act of 1921 was the last act to provide for excess profits taxes based upon "invested capital" and "special assessment" and 1921 was the last taxable year to which these provisions were applicable. Accordingly, it is now almost fifteen years since the latest returns were filed which could involve the question here considered. Obviously, it would be a very exceptional case in which the statute of limitations would not have run against both the Government and the taxpayer. Therefore, this issue could not possibly be of general importance and, in fact, it is doubtful whether any other case would be affected by a decision of the Supreme Court in this case.

5. *Court's Reasoning Sound.* The reasoning of the court below on this question is full, well-considered, and sound. As there stated, the profits tax is provided for in Title III of the Act, which is complete in itself and entirely separate from Title II which provides for the income tax. There

are separate provisions in the two titles for returns, in Sections 239 and 336. As a matter of fact the "net income" for purposes of the income tax is materially different from the "net income" determined for purposes of the profits tax.

The mere fact that a deduction of the profits tax is allowed in determining the net income subject to the income tax is not important; similar deductions were allowed for property taxes, franchise taxes, and State income taxes. Section 236(b) provides for the deduction of "the amount of any taxes imposed by Title III for the same taxable year." The only test is the *amount* imposed and it is immaterial *how* it was determined.*

This is a case in which the Commissioner, as held by the courts, made an erroneous determination of net income—a determination involving no discretion. The petitioner's argument that this error must stand uncorrected (merely because the taxpayer was entitled to and received treatment under Sections 327 and 328 as to its profits tax) imputes to Congress an unreasonable intention.

If in this case the Commissioner's overstatement of net income cannot be reviewed and corrected at the taxpayer's instance, it is unique in the system of corrective justice set up by the tax laws.

Far from being inconsistent with the decisions of the Supreme Court, the decision and opinion of the court below carry out both the letter and the spirit of the principles laid down by this Court. The profits tax determination by the Commissioner under Title III was not altered or questioned in any respect; on the contrary, the amount so determined was followed exactly in computing the net income subject to the income tax.

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* Examination of the Revenue Act of 1918 discloses that with the exception of Titles I, XIII and XIV, which contain "General Provisions", each of the other eleven titles covers a different form of tax, and that they are mutually independent. There would appear to be no reason why the method of computation of the tax imposed under one title should preclude the review and revision of the tax imposed under any other title.

The court below, while giving full faith and credit to the Commissioner's determination of the profits tax, has determined errors made in the computation of income for purposes of the separate and distinct income tax. Congress provided that this tax should be at the fixed rate of 10 per cent upon net income determined in accordance with the provisions of Title II and has left no discretion to the Commissioner in this respect. The court below has merely applied this fixed rate to the correct net income, so determined.

CONCLUSION.

The court below has correctly applied the law in accordance with the principles found in the decisions of this Court, and there is no sound reason of law, equity or policy why its judgment should be reviewed or changed.

WHEREFORE, it is respectfully submitted that the petition for a writ of certiorari should not be granted.

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APPENDIX.

Revenue Act of 1918, 40 Stat. 1057:

Title II—Income Tax

CREDITS ALLOWED.

Sec. 236. • • •

(b) The amount of any taxes imposed by Title III for the same taxable year: *Provided*, That in the case of a corporation which makes return for a fiscal year beginning in 1917 and ending in 1918, in computing the tax as provided in subdivision (a) of section 205, the tax computed for the entire period under Title II of the Revenue Act of 1917 shall be credited against the net income computed for the entire period under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, and the tax computed for the entire period under Title III of this Act at the rates prescribed for the calendar year 1918 shall be credited against the net income computed for the entire period under this title;

CORPORATION RETURNS.

Sec. 239. That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Returns made under this section shall be subject to the provisions of sections 226 and 228. When return is made

under section 226 the credit provided in subdivision (c) of section 236 shall be reduced to an amount which bears the same ratio to the full credit therein provided as the number of months in the period for which such return is made bears to twelve months.

Revenue Act of 1918, 40 Stat. 1057:

Title III—War-Profits and Excess-Profits Tax

Sec. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

Sec. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemp-

tion of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of ½ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to

such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

Sec. 336. That every corporation, not exempt under section 304, shall make a return for the purposes of this title. Such returns shall be made, and the taxes imposed by this title shall be paid, at the same times and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payment of income tax by corporations for the purposes of Title II, and all the provisions of that title not inapplicable, including penalties, are hereby made applicable to the taxes imposed by this title.